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C O N F I D E N T I A L ULAANBAATAR 000536

STATE FOR EAP/CM, EAP/EX, AND EB/IFD/OMA
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SUBJECT: MONGOLIA'S FINANCIAL SYSTEM STILL STANDING AFTER A
SHAKY WEEK

REF: A. ULAANBAATAR 527
[1](#)B. ULAANBAATAR 521
[1](#)C. ULAANBAATAR 474
[1](#)D. ULAANBAATAR 479

Classified By: ECONOMIC/COMMERCIAL OFFICER VINCENT D. SPERA FOR REASONS
1.5 (B) AND (D)

[¶](#)11. (C) SUMMARY. Mongolia's financial system has been rocked in recent days by a rapid decline in the local currency's value and the subsequent insolvency of its fourth largest bank. Some quick moves by the central bank to maintain the dollar supply and largely calm, even-handed responses by the other commercial banks have helped the system withstand the first part of the storm, but significant concerns remain. In the short-term, the central bank will work closely with the remaining 15 banks to ensure sound business practices and ward off a run on deposits. The central bank is also prepared to infuse dollars when needed to manage a gradual decline of the currency. Over the medium-term, the government has requested a financial program with the International Monetary Fund, and hopes that such a program could be put into place before it exhausts the dollar reserves needed to shore up the system. END SUMMARY.

TUGRUK'S DROP BRINGS MORE THAN JITTERS

[¶](#)12. (C) The first signs of a brewing financial storm hit Mongolia the week of December 1, with the local tugruk falling some nine percent against the dollar (from 1145 Tg to 1250 Tg for one dollar). Many observers attributed this to a flurry of dollar transfers out of the system over the preceding two weeks. The CEOs at two of Mongolia's "big three" banks hesitated to confirm the scale and scope of transfers, but did concede to Post's Comm Specialist that some shifting of funds was underway and that the trend was likely to continue.

[¶](#)13. (C) In a December 12 meeting with EconOff, Bank of Mongolia (the central bank, or BOM) First Deputy Enkhuyag confirmed that depositors were not only transferring tugruks into dollars but also transferring those dollars out of the country. Enkhuyag specifically highlighted two significant

transfers -- the first a USD 30 million transfer to Japan by leading telecomm company Mobicom shareholders, and the second an unnamed USD 60 million transfer from "one of the large banks."

¶4. (SBU) These and other smaller transfers are also compounded by fewer dollars flowing into Mongolia in general.

As noted in refs A, B, and C, the recent drop in commodity prices has taken a toll on Mongolia's revenues. In recent years, the sale of most of Mongolia's commodities, especially copper, has brought a steady flow of dollars into state coffers, supporting the dollar's liquidity. As copper prices have dropped by more than 50 percent in recent months, so too has the flow of dollars. When compounded by large dollar transfers out of the country, the dollar has become more scarce and, in turn, more valuable.

¶5. (C) Enkhuyag added that the tugruk has further to fall and that the BOM is trying to manage the decline to avoid a panic. It has already injected into the banking system USD 440 million of its USD one billion in dollar reserves to support the tugruk, and did manage to halt the steep rate drop by December 5. It is also prepared to use an additional USD 320 million for this continued purpose. The final USD 240 million in the reserves is "untouchable" as it makes up the country's Development Fund of past mining revenues set aside to support the government budget during down times.

¶6. (C) Enkhuyag noted that given the dwindling dollar reserves, the government has formally requested a program with the International Monetary Fund (IMF). The BOM hopes that a program could be put in place by the end of February, in which case it would have enough reserves to continue supporting the currency. The problem facing Mongolia, however, is that it is one of several countries requesting IMF support, which may make quick negotiation difficult.

¶7. (C) Enkhuyag also said that the BOM is expecting increased dollar revenues from gold sales. The parliament recently increased the threshold price at which a "windfall profit tax" is applied to gold, and as a result the supply of gold to the BOM from miners is expected to rise. Resulting sales would then also take pressure off of the dollar reserves, assuming the sellers do not send proceeds immediately abroad.

PENDING BANK FAILURE MUDDIES THE WATERS

¶8. (C) Just as the BOM had stabilized the tugruk, it was forced to take control of Anod Bank, Mongolia's fourth largest (although much smaller than the top three), on Wednesday, December 10. In the Thursday, December 11 media flurry, the BOM stopped short of declaring Anod bankrupt, and sent reassuring messages that the action effectively secures depositor money and will allow for a full cleansing of recent shaky bank practices. Anod has been under investigation for the past two years, and the most recent inspection revealed that the bank's 180 billion tugruks (approximately USD 144 million) in loans was offset by only 145 billion tugruks (approximately USD 116 million) in deposits. Further, the bank's accounts are grossly over concentrated, with only 3,000 of the bank's 60,000 depositors controlling 130 billion deposited tugruks (89.7 percent of deposits).

¶9. (SBU) Other banking sources tell us that late last week Anod informed the BOM that unnamed individuals had sent substantial funds abroad, presumably leading to the credit/debit imbalance. In addition, Anod management claimed that the bank's owners, before current management had taken over, had provided loans for themselves in excess of 50 billion tugruks (approximately USD 40 million). These funds now appear to be unrecoverable, as they were likely sent abroad or given with worthless security, such as shares in a collapsing bank.

¶10. (C) On the subject of Anod, BOM First Deputy Enkhuyag confirmed to us that, as per public reports, the BOM is guaranteeing all deposit accounts. He added that the public

guarantees made on December 11 appear to have stopped the bleeding and warded off a major run on deposits from Mongolia's other 15 banks. He expressed confidence that the other banks -- especially Mongolia's three largest banks -- are handling the situation calmly and professionally, and expects all 15 and the system as a whole to survive.

¶11. (C) The next big test will come on Monday, December 15, when the BOM plans to open Anod's doors to depositors. Enkhuyag stated that the BOM will pay out on all depositor accounts (save those under investigation) with no limits, but not accounts tied to loans. He remains optimistic that the BOM will be able to segregate the "good" accounts from the "bad accounts" quickly, and then cut its losses on the problem accounts. Then it would either sell the good ones off to other banks or rebuild Anod -- possibly via South Korean investment -- using the remaining solid deposits and loans.

COMMENT

¶12. (C) Enkhuyag's assessment of the situation seems consistent with the perceptions of the banking and business community, and the BOM's recent actions have taken some of the edge off of the sense of panic surrounding the financial sector. As post has reported previously (see ref D), Mongolia's financial system is fundamentally sound and -- the current problems with Anod aside -- has proven steady over the past decade. Anod has been a problem bank for some time so its pending failure does not necessarily suggest a system-wide illness. At the same time, even before Anod's problems some observers have argued that Mongolia has too many banks and financial institutions for a country its size.

¶13. (C) A bigger question is the BOM's capacity to manage the crisis as dollar reserves dwindle. Its current, seemingly rational approach could unhinge quickly due to events out of its control, such as continued commodity price swings, IMF attention to other countries and regions, economic issues in import-supplying countries, etc. The BOM's recent actions show that it may be up to the task, but will need more than a little help from friends -- the IMF, the other commercial banks, and other international partners -- to negotiate the coming weeks and months.

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